

as part of their discretionary management of client securities, the federal securities laws do not specifically address how advisers must exercise this power. New rule 206(4)–6 is designed to ensure that advisers that have proxy voting authority vote clients' securities in the clients' best interest and provide clients with information on how their securities are voted. In addition, these advisers must keep records that permit the Commission to confirm their compliance with rule 206(4)–6.

Investment advisers registered with us have discretionary authority to manage \$19 trillion on behalf of their clients, including large holdings in equity securities. In most cases, clients give these advisers authority to vote proxies relating to equity securities. This enormous voting power gives advisers significant ability collectively, and in many cases individually, to affect the outcome of shareholder votes and influence the governance of corporations. Advisers are thus in a position to significantly affect the future of corporations and, as a result, the future value of corporate securities held by their clients.

Under the Advisers Act, an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting. The duty of care requires an adviser that has authority to vote its client's proxies to monitor corporate events and to vote the proxies. To satisfy its duty of loyalty, the adviser must cast the proxy votes in a manner consistent with the best interest of its client and must not subrogate client interests to its own.

An adviser may have conflicts that can affect how it votes proxies. For example, the adviser (or its affiliate) may manage a pension plan, administer employee benefit plans, or provide brokerage, underwriting, insurance, or banking services to a company whose management is soliciting proxies. Failure to vote in favor of management may harm the adviser's relationship with the company. The adviser may also have business or personal relationships with other proponents of proxy proposals, participants in proxy contests, corporate directors or candidates for directorships. For example, the adviser may manage money for an employee group, or an executive of the adviser may have a spouse or other close relative who serves as a director or executive of a company. Our concern with these conflicts and how they affect clients of advisers led us to propose, on

September 20, 2002, new rule 206(4)–6 and amendments to rule 204–2.³²

New rule 206(4)–6 is designed to prevent material conflicts of interest from affecting the manner in which advisers vote clients' proxies. The rule requires SEC-registered investment advisers that have authority to vote clients' proxies to adopt written policies and procedures reasonably designed to ensure that the adviser votes proxies in the best interest of its clients, including procedures to address any material conflict that may arise between the interest of the adviser and the clients. The adviser must describe these policies and procedures to clients, provide copies of the policies and procedures to clients upon their request, and disclose to clients how they may obtain information from the adviser about how the adviser has voted their proxies.

The amendments to rule 204–2 under the Advisers Act require SEC-registered investment advisers that vote client proxies to maintain specified records with respect to those clients. These records will permit our examiners to ascertain the advisers' compliance with new rule 206(4)–6.

Based on advisers' filings with us, we estimate that the majority of investment advisers registered with us will be subject to the new rule. SEC-registered advisers are not currently required to submit information to us describing their proxy voting practices. However, according to our records as of September 9, 2002, 6,203 of the 7,687 advisers registered with us manage client assets on a discretionary basis.³³ Because in most instances, advisers with discretionary investment authority are given authority to vote proxies relating to equity securities under management, it is likely that significant numbers of these 6,203 advisers vote proxies on behalf of one or more clients in connection with providing their discretionary asset management services.³⁴

The Commission has given consideration to the costs of new rule 206(4)–6 and amendments to rule 204–2, as well as the benefits. In the

Proposing Release we requested comment and specific data regarding these costs and benefits. The comments we received were mostly general in nature and are discussed below. We received one comment that included data and estimated the cost of our proposal to be slightly higher than our figure. In light of the changes we are making to the rules as adopted, we believe our original figures accurately estimate the costs of the rule and rule amendments.

B. Benefits

Rule 206(4)–6 will, we believe, provide several important benefits to advisory clients. Requiring advisers to have written proxy voting policies and procedures that address material conflicts of interest will benefit clients by ensuring that their advisers do resolve conflicts in the clients' best interests. Requiring advisers to describe their proxy voting policies and procedures to clients and to furnish copies to clients upon request will benefit clients by allowing them to understand how their advisers vote proxies. Clients will also be in a better position to evaluate whether their advisers' policies and procedures meet their own objectives and expectations. Many individual commenters that they do want their advisers' policies and procedures to be available to them. Clients who do not approve of how their adviser votes their proxies may decide to reclaim the responsibility to vote proxies, provide the adviser with instructions on how to vote their proxies, or seek a different adviser whose voting policies they approve. Finally, requiring advisers to disclose to their clients how the clients can obtain information on how the advisers voted their proxies will benefit clients by allowing them to be fully informed about how their shares were voted and to confirm that their advisers are following their voting policies and procedures.

The benefit of codifying these practices through a rule is difficult to quantify, for two reasons. First, commenters confirmed that some advisory clients are already receiving these benefits as a matter of practice. Many advisers commented that they already have proxy voting policies and procedures in place, and that they already provide much of this information to clients. Second, the adviser is an agent and fiduciary of its clients; it already owes them a fiduciary duty to vote proxies in the clients' best interest, and must provide them with information on how their proxies were voted.

³² See *supra* note 6.

³³ This estimate is based on information submitted by SEC-registered advisers on Form ADV [17 CFR 279.1]. 6,203 SEC-registered investment advisers reported on Part 1A of their Form ADV that they provide continuous and regular supervisory or management services for client securities portfolios on a discretionary basis.

³⁴ Part 1A of Form ADV does not require advisers to describe the types of securities for which they hold discretionary investment authority. Some advisers that report having discretionary assets under management may manage only securities for which proxy voting issues do not arise, such as government or other debt obligations.